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Before the
UNITED STATES COPYRIGHT ROYALTY JUDGES
LIBRARY OF CONGRESS
Washington, D.C.

In the Matter of:	
DETERMINATION OF RATES AND TERMS FOR MAKING AND DISTRIBUTING PHONORECORDS (PHONORECORDS III)	Docket No. 16–CRB–0003–PR (2018–2022)

COPYRIGHT OWNERS' REPLY IN FURTHER SUPPORT OF THEIR MOTION FOR CLARIFICATION OR CORRECTION OF TYPOGRAPHICAL ERRORS AND CERTAIN REGULATORY TERMS (the "Motion")

Unopposed Aspects of The Motion

The Services offer no objection to the clarifications proposed by the Copyright Owners (the "COs") on the following points in the Motion, and the related edits are unopposed and merit adoption: (a) the definitions of Service and Offering Service (Motion § A); (b) the definition of Offering (part of Motion § B); and (c) the definition of Locker Service (part of Motion § H).[1]

Motion Section B: Licensed Activity

The COs proposed only one change to the definition of Licensed Activity: to remove new Subpart B products (physical phonorecords, permanent digital downloads, and ringtones) from the definition, and the Services agree with this change. The Services, however, object to the "includes but is not limited to" language added by the Judges, claiming it will sweep into Licensed Activity "not only new Subpart B, but also old Subpart C products and services," which, they argue, "the Judges did not intend to include." Opp. at 7-8. This argument makes no sense: the Judges specifically reference old Subpart C products in the definition and obviously intended to include them. *See* Determination Ex. A § 385.2 ("*Licensed Activity* includes but is not limited to . . . provision of Limited Offerings, Bundles, and Locker Services").[2]

Motion Section E. Student Plan

While the Services seek rehearing on the minutiae of definitions, claiming they "could be misconstrued" and "leave open the possibility" of misinterpretation, they casually dismiss defining *at all* the term "student," on which a massive royalty rate discount turns.

The COs seek to employ the definition of Student Plan *proposed by every Service that proposed a student plan* (*i.e.*, Amazon, Pandora and Spotify). The Services' cynicism is obvious in abandoning their own consensus Student Plan definition, hoping to exploit an inadvertent omission in the draft Regulatory Terms defining students, a term that allows for a fifty-percent

[1] Further, the following sections are addressed in the stipulation adopted by participants as Attachment A to the motion responses: Definition of Play (Motion § C); Definition of Total Content Cost and Applicable Consideration (Motion § D); and Family Plan Proration provision (Motion § F).

[2] For the sake of brevity, unless otherwise noted, all emphases herein are supplied.

discount in the subscriber-based royalty floors.[3] The scope of a Student Plan must be defined, and under the Determination, that definition should be the one originally proposed by the Services.

Motion Section G. Subpart C Subscriber-Based Royalty Floors

The Services' contrived semantic argument – that the term "subscriber-based royalty floor" somehow does not include the two Subpart C subscriber-based royalty floors because they are "minima" and not "floors" – is simply wrong. The title of the current regulation that created these floors calls them "subscriber- based royalty floors," as do the very rate proposals submitted by the Services. The extant Subpart C creates only two rate prongs involving subscriber counts, the same two that are the subject of this Motion. The title of the section that creates them, §385.23, is: "Royalty rates and subscriber-based royalty floors for specific types of services," and it begins with, "The following royalty rates and subscriber-based royalty floors shall apply to the following types of licensed subpart C activity…"[4] The first page of the Determination states: "The existing subscriber-based royalty floors shall remain in effect during the new rate period." Thus, there is nothing in the Determination indicating an intention to omit these floors (and neither Amazon, Spotify nor Pandora requested removal of these floors in their rate proposals).[5] There is no justification for opposing the inclusion of these floors and the Services' semantic opposition is refuted by the regulations and their own proposals.

Motion Section H: Purchased Content Locker Service

The evidence shows that Purchased Content Locker Services have always been storage services offered free to the user that permit the user to store digital copies of recordings that they

[3] The Services' argument for a college student discount was that it served an *actual* low willingness-to-pay ("WTP") consumer group. The Services did not seek unfettered discretion to implement any discounts they wanted and have them subsidized by songwriters. They argued that they had *actually identified* two low-WTP groups – college students and families – and that discounts to the floors would allow them to serve these two actual low-WTP groups, which the Judges accepted. (Determination at 90.) The Services' opposition to *their own proposed language* reveals that their argument was really just about royalty reduction, not low-WTP groups.

[4] This same language was explicitly included in the Amazon, Pandora and original Google rate proposals, and by implication in the Spotify proposal which sought no change to the current Subpart C regulations.

[5] "Floor" and "minimum" are synonyms. Indeed, the general use of the term "mechanical-only floor" accurately signals that the term "floor" alone encompasses more than mechanical-only floors.

have purchased from a qualifying seller.[6] This is how they are defined in the prior regulations, *see id.*, and this is why they are called "*Purchased Content* Locker Services." The Determination evinces no intent to broaden the definition of Purchased Content Locker Services to include non-purchased content, or to go beyond what they are and have been in the marketplace and beyond the definition in the prior regulations (see Determination at 92, referring to "the existing regulations"), a definition that every Service proposed to be carried forward.[7]

The Services' argument here is again an attempt to exploit an inadvertent oversight in the new Regulatory Terms, and to broaden the definition beyond what any Service even proposed, to permit storage of files that were not purchased but are merely "in possession of" the user (such as pirated files). Limiting "Purchased Content Locker Services" to purchased content does, in fact, reflect the Judges' intent that those locker services be free because they are promotional (of the purchases). *See* Opp. at 10. Allowing royalty-free streaming of pirated music files is contrary to the Determination, and promotes nothing but piracy.

Motion Section I **Promotional Offering and Free Trial Offering**

Here again, the Services try to exploit inadvertent definitional implications in the Determination, contradicting their own proposals in effort to snare a "freebie." The Services concede that the Judges expressed a clear intent to **not** change the extant regulations on promotional streams, but disingenuously argue that the new Promotional Offering definition is "nearly identical to" the extant § 385.14, "with minor word changes." Opp. at 9. It is not. The Services ignore that the new definition (a) sweeps in New Subpart B products (with the unintentional consequence of

[6] *See, e.g.,* Apple Reply to COL-98 ("First, there are purchased content locker services. These are free services that allow consumers who purchase music from the service that offers the locker to store that music in the cloud and listen to it from the cloud. 37 C.F.R. § 385.21. Thus, with purchased content locker services there is zero risk of piracy. The service offering the locker knows that the music in the locker properly was paid for and that the royalty fee has been paid to the publisher…"); Ghose WDT (Hearing Ex. 1617R) ¶ 93 ("Purchased content locker services provide users the ability to access music that they have already purchased…"); Tr. 1407:13-23 (Mirchandani); Dorn WRT (Hearing Ex. 1612) ¶ 41.

[7] *See* Apple Inc. Proposed Rates and Terms at 6-7; Google Inc.'s Amended Proposed Rates and Terms at 23-24; Proposed Rates and Terms of Pandora Media, Inc. (As Amended) at 23; Amazon Digital Services LLC's Proposed Rates and Terms at 8 (term does not appear, as no change to definition is proposed); Second Amended Proposed Rates and Terms of Spotify USA Inc. at 22 (proposing no change to Subpart C or its definitions).

changing the New Subpart B settlement and the regulations effectuating that settlement); (b) introduces ambiguity by including promotion by a label or Service for which the label or Service receives no consideration other than "in-kind promotional consideration," which is undefined and unclear; and (c) could lead to a mistaken assumption that there was an unintentional expansion of the scope of activities subject to a zero rate – all concerns identified by the COs in the Motion. Moreover, Promotional Offerings (other than Free Trial Offerings) under § 385.14 are further limited, in among other ways, as to number of sound recordings (§ 385.14(a)(v)), and require that an opportunity to purchase or subscribe be offered (§ 385.14(a)(vi)), and Promotional Offerings of clips are limited to 90 seconds in duration (§ 385.14(d)). These limitations, among others, are absent from the new definition, significantly changing a definition regarding zero-rate activities that the Judges explicitly intended to not change.

Motion Section J. <u>Bundle Service Revenue</u>

The Services argue that the service revenue definition for bundles cannot be corrected because "no analysis was ever conducted or provided to the Judges regarding the likely effects of the definition on either the Service or the market."[8] This argument ignores that the COs presented extensive evidence of the Services' misuse of the existing definition to defer and displace revenues,[9] that industry uncertainty exists under any definition, and that CRB rate determinations often implement rates and terms that were not the proposal of any participant. Rate proceedings have never been baseball arbitrations where one or another proposal must be adopted as stated. The Determination contains no reasoning to justify the extant definition, which appears to have been inadvertently included and which conflicts deeply with the Judges' general reasoning.

[8] Notably, no analysis was also ever conducted or provided on the future effects of (1) implementing an undefined "student plan" discount; (2) changing the definitions of promotional offerings; (3) changing the definitions of purchased content locker services; and other terms that the Services now argue should be implemented. The Services' argument here is plainly pretextual as they otherwise have no problem with the Judges revising definitions.

[9] A sampling of this evidence is referenced at COL-360 – COL-390. The Services also make incorrect claims about what the Determination says about bundle fairness, including that it "consider[s] and reject[s] [the] argument that 'the Services might obscure royalty-based streaming revenue by offering product bundles … rendering it difficult to allocate the bundle revenue'" A plain reading of the Determination indicates that it hardly rejects this point, but rather accepts it – this risk is pointed out by the Judges in describing problems with bundles that even the Services' own experts "acknowledge." Determination at pp. 19-20.

As the Motion notes, the bundling revenue definition is based on economic reasoning that is *exactly* what the Judges labelled "absurd" in the *Web IV* proceeding, and it is unreasonable to believe that the Judges intended to adopt, without explanation, a revenue definition that employs economic reasoning that they found absurd.[10] This is particularly true when the Services failed to provide any evidence or expert testimony justifying that definition.

Nor should the Services be allowed to shift the burden on this point. *SDARS III* addressed this precise issue and made clear that *the Services* "must bear the burden of providing evidence that might mitigate the acknowledged 'economic indeterminacy' problem inherent in bundling"– persuasive evidence of the separate values of constituent parts of bundles. *SDARS III*, p. 114; *Ruling on Referred Questions,* No. 2006-1 CRB DSTRA (2007-12) (Sept 11, 2017), pp. 20-22. The COs repeatedly called out this economic indeterminacy throughout the Hearing, objecting to this precise definition that allowed such absurd results. *See, e.g.*, COF-438 – COF-440, COF-465 – COF-480, COF-519, COF-543, COF-553, COF-558 – COF-570. Yet the Services chose to offer no evidence that the economic indeterminacy problem has been resolved or *even any argument at all* to justify the bundle revenue definition at issue here.[11]

Short of including all bundle revenues as in *SDARS III*, the Judges can at least use the Services' own market price (or comparables) for the music product for bundle allocation purposes. The reasoning of prior rulings indicates that less than this is not an economically justifiable definition. Nor is such definition contrary to the Judges' appreciation of price discrimination. *See SDARS III* at p. 114 (acknowledging price discrimination features of bundling, but rejecting service's definitional argument because of economic indeterminacy created by the service).

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[10] The dissent seeks to contrast bundling in this context with bundling in *SDARS,* arguing that the adoption of alternative royalty prongs (to the revenue prong) "is one way to resolve the indeterminacy problem." Dissent, p. 72, fn 108. However, this distinction fails to account for the fact that the per-user minimum for bundles is only 25 cents, one half of the standard portable per-user minimum, thus providing no real backstop against material royalty reduction. The TCC prong is also less effective protection in the case of bundling as Record Companies may be compensated via "other components" of the bundle.

[11] Notably, the Services had every opportunity to address the economic indeterminacy of their bundling, or attempt to justify the current definition for bundle revenues, particularly as the bundling rate structure established for the coming period (greater of (1) percent of revenue and (2) uncapped TCC (less performance royalties) and (3) mechanical-only floor) is identical to the current bundling rate structure that was also proposed by the Services.

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Respectfully submitted,

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Certificate of Service

I hereby certify that on Monday, March 12, 2018 I provided a true and correct copy of the Copyright Owners' Reply to Services' Joint Opposition to COs' Motion for Clarification or Correction of Typographical Errors and Certain Regulatory Terms to the following:

Google Inc., represented by Ivana Dukanovic served via Electronic Service at idukanovic@kslaw.com

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Signed: /s/ Benjamin K Semel